COMMONWEALTH OF KENTUCKY
KENTUCKY SUPREME COURT
NO. 2015-SC-107-D

INDIANA INSURANCE COMPANY — APPELLANT

v. ON DISCRETIONARY REVIEW FROM COURT OF APPEALS NO. 2013-CA-338
CAMPBELL CIRCUIT COURT NO. 09-CI-1175

JAMES DEMETRE — APPELLEE

REPLY BRIEF OF APPELLANT INDIANA INSURANCE COMPANY

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Certificate of Service

This is to certify that this Reply Brief has been served by mailing a true copy thereof, postage prepaid, on this 8th day of March, 2016, to Jeffrey M. Sanders, Esq., Jeffrey M. Sanders, PLLC, 437 Highlands Avenue, Fort Thomas, KY 41075; Robert E. Sanders, Esq., Justin E. Sanders, Esq., The Sanders Law Firm, 1017 Russell Street, Covington, KY 41011; Kevin C. Burke, Esq., 125 South 7th Street, Louisville, KY 40202; Ronald L. Green, Esq., 201 East Main Street, Suite 1250, Lexington, KY 40507; Hans G. Poppe, Esq., Justice Plaza, 8700 Westport Road, Louisville, KY 40242; and Hon. Fred A. Stine IV, Judge, Campbell Circuit Court, 330 York Street, Newport, KY 41071.

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STATEMENT OF POINTS AND AUTHORITIES

I. INDIANA INSURANCE WAS ENTITLED TO A DIRECTED VERDICT.

Indiana Insurance defended and fully indemnified Demetre. When coverage issues were identified, which both Demetre and his expert admit were legitimate coverage issues,[1] Indiana Insurance sought a judicial resolution of those issues. Once they were resolved and coverage found to exist, Indiana Insurance settled the claims against Demetre. Demetre presents nothing to take away from the evidence establishing as a matter of law that Indiana Insurance did not act in bad faith when it acted consistently with this Court's Opinion in *Guaranty Nat'l Ins. Co. v. George*, 953 S.W.2d 946 (Ky. 1997). The undisputed material facts left nothing for the jury to decide.

Demetre's arguments about the filing of the declaratory judgment action (and subsequent amended declaratory claims) ignore this Court's holding in *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512, 522-23 (Ky. 2006), that ligation conduct cannot be the basis of a bad faith claim. If in fact Indiana Insurance filed and pursued a meritless declaratory judgment action, the remedy for that conduct is provided by the Civil Rules. *See* Ky. R. Civ. P. 11. Under *Knotts v. Zurich*, that litigation conduct cannot be the basis of a bad faith claim. Thus, Demetre's continued arguments about what Indiana Insurance put him through, such as Indiana Insurance "put him through three years of costly, stressful litigation," Demetre Brief, at 22, simply show that Demetre did not have a bad faith claim against Indiana Insurance.[2]

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[1] *See* Demetre brief, at 33 ("Demetre has never alleged that Indiana Insurance committed bad faith by simply challenging coverage."); Testimony of Carl Grayson at VR 9/26/12; 2:28:54.
[2] This Court in *Knotts* indicated that, under KRS 304.12-230, an insurer's settlement duties continue after litigation is commenced. Demetre's bad faith claim was in no way based on Indiana Insurance's settlement conduct.

Demetre argues that Indiana Insurance's focus on the coverage issues resulted in Indiana Insurance not conducting a speedy enough investigation of the claims asserted against Demetre. However, the Indiana Insurance policy states that Indiana Insurance "may, at [its] discretion investigate any 'occurrence' and settle any claim or 'suit' that may result." Recognizing a cause of action for an allegedly inadequate investigation would be to rewrite the parties' agreement, which this Court has vowed not to do. *See, e.g., St. Paul Fire & Marine Ins. Co. v. Powell-Walton-Milward, Inc.*, 870 S.W.2d 223, 226-27 (Ky. 1994).

Demetre's statement that KRS 304.12-230(4) requires an insurer "to conduct a reasonable investigation based upon all available information," Demetre Brief, at 25 n.101, is neither true nor material. As recognized in *Motorists Mutual Ins. Co. v. Glass*, 996 S.W.2d 437, 454 (Ky. 1997), that provision requires that a payment not be refused without a reasonable investigation, which is far different than imposing upon an insurer an independent duty to investigate. Demetre did not make a claim for payment. Any duties regarding payment of a claim under that section would have been owed to the Harris family, not Demetre.

Demetre cites cases in support of his "delay in investigation" argument that actually provide no support at all because they are irrelevant. *Phelps v. State Farm Mut. Auto. Ins. Co.*, 763 F.3d 697 (6th Cir. 2012) and *Hamilton Mut. Ins. Co. v. Buttery*, 220 S.W.3d 287 (Ky. App. 2007), both dealt with a delay in the payment of a claim, not a delay in investigating a claim. Demetre made no claim for payment. And while KRS 304.12-230(6) requires an insurer to attempt in good faith to effectuate prompt, fair and equitable settlements of claims once liability has become reasonably clear, Demetre has

never argued that the claim against him should have been settled earlier, and in fact was critical that it was settled at all. *King v. Liberty Mut. Ins. Co.*, 54 Fed. Appx. 833 (6th Cir. 2003), involved a delay in confirming the settlement of a prior claim. None of those cases dealt with a claim by an insured that an insurer improperly delayed the investigation of a claim asserted against the insured.

According to Demetre, a speedier investigation would have shown that the claim against Demetre was meritless.[3] Of course, that would not have brought the claim against Demetre to an end any sooner, nor have resolved the coverage issues any sooner. In fact, the evidence showed that Indiana Insurance's investigation was more than adequate for the defense of Demetre. He was represented by counsel provided by Indiana Insurance at all times and the claims against him were settled within the coverage provided by the Indiana Insurance policy.

In *Capstone Building Corp. v. American Motorists Ins. Co.*, 67 A.3d 961 (Conn. 2012), the Connecticut Supreme Court cogently explains why an alleged failure to investigate should not give rise to a bad faith claim when the insurer provides it's insured with a defense and indemnity. As here, the policy in *Capstone Building* gave the insurer discretion to investigate and settle claims as it saw fit. The Court explained:

> Although we recognize that a discretionary investigation is often necessary to assess the duty to defend or indemnify under the policy, a bad faith action is properly addressed to the insurer's conduct depriving the insured of those contractual benefits, rather than the precedent, investigatory step . . . . A bad faith cause of action not tied to duties under the insurance policy must therefore fail as a matter of law.

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[3] In his brief, Demetre vacillates between the Harris claims being very serious, suggesting that Indiana Insurance should have been doing more in defense of the claim, and the claims were totally without merit.

Id. at 987-88.

Capstone Building recognized that its conclusion, that bad faith is not actionable apart from a wrongful denial of a benefit under the policy, is supported by both authoritative treatises and the majority of jurisdictions. *Id.* at 798–800. Kentucky is among those jurisdictions, based on the recognition in *Wittmer v. Jones* , 864 S.W.2d 885 (Ky. 1993), that the denial of something owed under the policy is an essential element of a bad faith claim. *See* 864 S.W.2d at 890 (first essential element of a bad faith case is that something is owed under the policy).

Demetre presented no evidence to support its argument that Indiana Insurance improperly interfered with Schenkel's representation of Demetre, or ever told Schenkel or anyone else what they could or could not do in representing Demetre.[4] While Demetre spends much of his brief portraying James Magi as the bad guy at Indiana Insurance, Magi supervised Schenkel for a very short period of time – September 25, 2009 to December 22, 2009. There is no evidence that James Magi interfered with Schenkel's representation of Demetre during that time.

In fact, there is no evidence of Indiana Insurance ever interfering with Schenkel's representation of Demetre. Very telling in that regard is the list of things that Indiana Insurance supposedly "did not allow defense counsel to do." Demetre Brief, at 28-29. But the citation there is to Demetre's Trial Brief, not to any evidence in the record. *See id.*, at 29 n.112. The actual evidence established just the opposite; for example, Schenkel suggested that an expert be retained, and the expert was retained. (VR 9/29/12; 4:44:14)

[4] Demetre did not call Schenkel as a witness, and in fact successfully objected to Indiana Insurance's attempt to call Schenkel as a witness. Thus, there is absolutely no evidence in the record from Schenkel or anyone else who represented Demetre that Indiana Insurance interfered with their representation of Demetre.

No evidence exists of Indiana Insurance instructing Schenkel to ***not*** do something he believed he should do in his representation of Demetre.[5] Rather, when Demetre complained about Schenkel, Indiana Insurance hired Demetre a new lawyer with whom, Demetre testified, he was very pleased.

II. *OSBORNE v. KEENEY* APPLIES IN BAD FAITH CASES.

Demetre presented no evidence of compensable damages. Indiana Insurance was entitled to a directed verdict because Demetre's entire case and damages claims ran afoul of the U.S. Supreme Court precedent of *State Farm Mut. Ins. Co. v. Campbell*, 538 U.S. 408, 423 (2003) ("A defendant should be punished for conduct that harmed the plaintiff, not for being an unsavory individual or business.").

Demetre's argument that this Court's adoption of the expert proof standard for emotional distress claims in *Osborne v. Keeney* is limited to stand-alone infliction of emotional distress claims makes little sense because *Osborne* was not a stand-alone infliction of emotional distress case. *Osborne* instead was a legal malpractice case in which plaintiff recovered compensatory damages in the form of: (1) loss of personal property from the underlying case; (2) pain and suffering from the underlying case; (3) lost punitive damages from the underlying case; (4) legal fees paid to Keeney; and (5) mental anguish resulting from Keeney's representation. *See* 399 S.W.3d at 7–8.[6] In adopting the expert proof standard for emotional distress claims, *Osborne* was not dealing with a stand-alone claim for emotional distress damages. Instead, this Court

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[5] In his avowal trestimony, Schenkel testified that it was Demetre's personal counsel who told him to not take discovery until after the coverage issues were resolved. (VR 9/26/12; 12:31:03)
[6] The jury in *Osborne* also awarded $3,500,000 in punitive damages against Keeney.

adopted the expert proof standard in *Osborne* in connection with what Demetre calls a "parasitic" claim for emotional distress damages.

If the expert proof standard adopted in *Osborne* is to be limited to stand alone claims for emotional distress damages, *Osborne* would have been decided differently. But *Osborne*, a recent, unanimous decision of this Court on this issue, was properly decided and the law adopted therein is clear: "A plaintiff claiming emotional distress must satisfy the elements of a general negligence claim, as well as show a severe or serious emotional injury, supported by expert evidence."[7]

Demetre's reliance on *Banker v. University of Louisville Athletic Ass'n,* 466 S.W.3d 456 (Ky. 2015), is misplaced, as there is no indication that the potential application of *Osborne* was raised therein; it certainly was not discussed by either this Court or the Court of Appeals. In addition, *Banker* is further distinguishable because it involved a Civil Rights Act claim for which there is a statutory basis for an award of emotional distress damages. *See McNeal v. Armour and Co.*, 660 S.W.2d 957, 958 (Ky. App. 1983). There is no similar statutory basis for an award of emotional distress damages in a bad faith case. The UCSPA certainly does not specify that emotional distress damages are available in a case brought for violation of the UCSPA.[8]

Demetre's reliance on *Amos v. Vanderbilt*, 62 S.W.3d 133 (Tenn. 2001), also is misplaced. In *Amos*, the Tennessee Supreme Court held that medical proof of a

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[7] The Court of Appeals recently applied *Osborne v. Keeney* in a medical negligence case. *See Doss v. Trover*, 2016 Ky. App. Unpub. LEXIS 16, * 16-22 (Ky. App. 2016) (copy attached as exhibit A).

[8] The drafters of the UCSPA never envisioned that a private cause of action would exist for an alleged violation of the UCSPA. NAIC Model Law, Regulations and Guidelines, Unfair Claims Settlement Practices Act, NAIC 900-1, Section 1. Purpose, Drafting Note (January 2008) ("A jurisdiction choosing to provide for a private cause of action should consider a different statutory scheme. The Act is inherently inconsistent with a private cause of action.").

plaintiff's emotional distress is unnecessary when "emotional damages are a 'parasitic' consequence of negligent conduct that results in multiple types of damages. . . ." 62 S.W.3d at 137. According to the Tennessee Supreme Court:

> Even before *Camper*, a plaintiff could recover for emotional injuries as one of several items of compensatory damages. . . . The *Camper* holding contemplated a plaintiff who was involved in an accident and received *only* emotional injuries. . . . The *Camper* holding did not alter the longstanding rule that emotional injuries are compensable if accompanied by additional claims for damages . . . .
>
> This is not a case, like *Camper*, in which the damages alleged are for mental anguish only.

Id.

The Court in *Amos* thus confirms that the rule in *Osborne* should be applied in this case, because this case is like *Camper v. Minor*, 915 S.W.2d 437 (Tenn. 1996), in that "the damages alleged are for mental anguish only." The only compensatory damages sought by Demetre, and the only compensatory damages awarded by the jury, were for his alleged emotional distress. Just as the holding in *Camper* contemplated a plaintiff who "received only emotional injuries," Demetre alleged only emotional distress injuries.

That is why *Osborne* applies to this bad faith case in particular. This was not a case in which Demetre asserted a "parasitic" claim for emotional distress damages along with other claims for damages. Emotional distress damages were the only compensatory damages sought by Demetre even though he sought no care or treatment at all. In such circumstances something is needed to substantiate those damages other than a claimant's self-serving testimony. This Court in *Osborne* held that the substantiation must come in the form of expert medical proof, which Demetre did not and could not offer.

Demetre and the amicus greatly exaggerate the state of the law in other jurisdictions. For example, the 44 cases cited in footnote 21 of the amicus's brief are simply cases recognizing that emotional distress damages are recoverable in a variety of types of cases. The majority of the cases cited therein are not even bad faith cases. A good example: the third case cited, *Richardson v. Fairbanks North Star Borough*, 705 P.2d 454, 455 (Alaska 1985), concerned "the proper measure of damages for the death of a pet dog caused by a municipality's negligence."

Significantly, none of those cases addresses the proof necessary to recover on a claim for emotional distress damages in a bad faith case. On that issue, those cases offer no help at all. And the claim that this Court would join an extreme minority by applying *Osborne* in this case is simply wrong. To the extent any of those cases actually stand for the proposition that expert testimony is not needed to prove a claim for emotional distress damages, this Court already resolved that issue differently when it decided *Osborne*.

Setting aside all of that misleading, irrelevant sleight of hand, very few courts have decided the specific issue of whether expert testimony is necessary to recover emotional distress damages in a bad faith case, particularly when the emotional distress damages are the only compensatory damages sought by the plaintiff. To be sure, no other jurisdiction had a recent, unanimous decision from the state's highest court proclaiming "[a] plaintiff claiming emotional distress must . . . show a severe or serious emotional injury, supported by expert evidence." *Osborne*, 399 S.W.3d at 23.

In *Time Ins. Co. v. Burger*, 712 So. 2d 389 (Fla. 1998), the Florida Supreme Court thoroughly analyzed the issue and concluded that a plaintiff in a bad faith case must offer expert evidence to support a claim for emotional distress damages. In language similar to

that used by this Court in *Osborne*, the court in *Burger* quoted from an earlier case that "[i]t would be far-reaching indeed to expand that notion to permit financial recovery for all of the emotional and mental strains which modern society inflicts on an individual by reason of its inevitable clashes." 712 So. 2d at 392, *quoting Butchikas v. Travelers Indem. Co.*, 343 So. 2d 816, 819 (Fla. 1976). The court then spoke to the predicament facing insurers if claimants could recover emotional distress damages in bad faith cases based solely on the claimants' own testimony:

> To allow recovery of compensatory damages for mental anguish on the basis of lay testimony would subject health insurers to such claims every time such an insurer contested a claim. Insurers would be pressured into paying claims that the insurer legitimately should dispute because, if a jury disagreed with the decision not to pay, the insurer would have the additional exposure of a claim for mental distress. Insurers have a right and a duty to other policyholders to contest illegitimate claims. This statute should not be given a construction which destroys that right or frustrates that duty. Payment of illegitimate claims raises the cost of insurance for all policyholders.

Id. at 393-94.

In light of those concerns (the same as recognized in *Osborne* and existing in this case), the court in *Burger* held that a claimant's allegations of emotional distress "will have to be substantiated by testimony of a qualified health care provider." *Id.* at 394. That is entirely consistent with this Court's decision in *Osborne*.

The cases cited by Demetre and the amicus in support of their position are far less persuasive. In *Nassen v. National States Ins. Co.*, 494 N.W.2d 231 (Iowa 1992), no argument was made that expert testimony was needed to substantiate the damages. In *Farmers Home Mut. Ins. Co. v. Fiscus*, 725 P.2d 234, 236 (Nev. 1986), the court summarily concluded that a husband's testimony that his wife suffered a "total emotional

breakdown" sufficiently supported an award of emotional distress damages. In *Jacobsen v. Allstate Ins. Co.*, 215 P.3d 649 (Mont. 2009), the Montana Supreme Court relied upon the state's pre-existing pattern jury instructions which included no definite standard to calculate compensation for mental and emotional suffering to conclude that a bad faith plaintiff did not have to prove that his or her emotional distress was severe "before a claim for parasitic emotional distress damages is allowed to go to the jury." 215 P.2d at 664. Of course, *Osborne* is exactly the opposite of the pre-existing Montana law.

As discussed above, Demetre's claim for emotional distress damages was not a "parasitic" claim, it was his only claim for compensatory damages. And that goes to the heart of the problem. As this Court and many others have recognized, a plaintiff seeking to recover emotional distress damages must make some substantiation before emotional distress damages can be recovered. Whether it be through an accompanying physical injury or property damage, or through an award of breach of contract damages, or through expert evidence supporting an emotional distress claim, there must be something to substantiate the claimed emotional distress. Particularly when emotional distress damages are the only compensatory damages sought, expert medical evidence should be required, as this Court recognized in *Osborne v. Keeney*. Because Demetre did not offer any expert evidence to substantiate his alleged emotional distress, the trial court erred in not granting Indiana Insurance's motion for a directed verdict. This case should be reversed and remanded to the trial court with directions to enter judgment in favor of Indiana Insurance.

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APPENDIX

A. *Doss v. Trover*, 2016 Ky. App. Unpub. LEXIS 16 (Ky. App. 2016)